in such a strategy are serious enough for us to take the preventive measure of adopting a Section 214 authorization condition at this time.

219. We disagree with HKTI that the potential relationship between above-cost settlement rates and anticompetitive behavior in the U.S. market is attenuated. The relationship is in fact straightforward. Settlement rates are an essential input for international termination services. The rates charged for that essential input are in most cases substantially above-cost. When a provider of that above-cost essential input enters the retail market that uses that input (the market for IMTS), it has the ability to price its retail services so that the relationship between "high" input prices and "low" retail prices forces competing retail providers either to lose money or to lose customers even if they are more efficient. HKTI states that there is no way the Commission could separate out the specific effects of above-cost settlement rates from other intracorporate cross subsidies. But, as discussed here, our concern is specifically with the potential market-distorting impact of above-cost settlement rates as an essential input for international termination services. HKTI further states that we cannot determine "distortion" in the international marketplace solely based on the level of settlement rates. It thus concludes that the Section 214 authorizations could not be applied in a nondiscriminatory and fair way and would be arbitrary and capricious as a result.[368] We disagree. We have specifically defined the competitive harm we seek to address through the authorization conditions: that a foreign-affiliated carrier can engage in price squeeze behavior on the affiliated route by virtue of its dual role as a provider of an above-cost essential input and a competitor in the retail market using that input.[369]

220. We note that AT&T expresses a broader concern about the effect a foreign-affiliated carrier providing service to its home market will have on the U.S. market. AT&T is concerned not only about predatory price squeezes, but also has a more general concern about all price-cutting behavior of foreign-affiliated carriers. AT&T believes that foreign carriers have an "unbeatable cost advantage" due to their parent's collection of above-cost settlement rates.[370] To the extent that AT&T argues that all price-cutting by U.S. affiliates of foreign

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[368] HKTI Comments at 25-26.

[369] HKTI states that there is no evidence that foreign carriers are in fact receiving significant "transfer payments" through settlements. HKTI states that in fact, "a proper calculation of net settlements, correcting for the diversion of direct revenues to U.S. carriers as a result of refile, callback and other reverse charge services, may show that deficits are actually incurred by foreign carriers." HKTI has provided no evidence, however, to support its claim that foreign carriers incur "deficits" as a result of these services. Moreover, contrary to HKTI's claim, we have shown that settlement rates are in almost all cases substantially above the level of costs incurred by foreign carriers to terminate international traffic.

[370] AT&T Comments at 42-43.

carriers is anticompetitive, we disagree. Such pricing behavior becomes detrimental to U.S. consumers' interests only when it could ultimately reduce the level of competition on particular international routes. A pricing strategy that undercuts competitors' prices but that is neither discriminatory nor potentially harmful to competition may be deemed unfair by some commenters since it would increase the profits of foreign carriers and reduce the profits of carriers in the domestic IMTS market. It does not, however, create distortions in the U.S. market for IMTS that require us to impose conditions.[376]

221. While we believe that carriers serving affiliated markets have the ability to engage in market-distorting price squeeze behavior by pricing below cost, we do not agree with AT&T that the only way to prevent such behavior is by conditioning a carrier's authorization to provide facilities-based service to an affiliated market on the affiliated foreign carrier offering U.S. carriers settlement rates on the affiliated route at or below a TSLRIC-based rate. Such a condition is not necessary to prevent distortions in the U.S. market for IMTS services, and in fact, it could harm the development of further competition in that market. We believe AT&T's proposed condition could effectively deter many carriers from providing facilities-based service from the United States to affiliated markets. This result would impede our goal of increasing competition in the U.S. market for IMTS to the detriment of U.S. consumers.[377]

222. We agree with AT&T's assertion that because settlement rate benchmarks based on the TCP methodology are above-cost, the facilities-based condition as proposed in the *Notice* does not completely eliminate the ability for foreign-affiliated carriers to execute a price squeeze. Requiring that a carrier's settlement rates be at or below the relevant benchmark before it may provide facilities-based service to an affiliated market, however, substantially reduces the above-cost termination charges that could be used to execute a price squeeze.[378] We also note our conclusion that foreign carriers collecting above-cost settlement

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[376] To the extent that AT&T has concerns that foreign-affiliated carriers may get an unfair advantage over other competitors in the U.S. market, we note that the Section 214 authorization conditions we adopt in this *Order* to address the potential for market-distorting behavior essentially require foreign carriers to forego a substantial portion of the monopoly rents in their settlement rates before using an authorization to provide service to an affiliated market. Thus, the unfair advantage AT&T fears will be substantially mitigated by our conditions to address anticompetitive behavior.

[377] As Sprint asserts, foreign carrier entry and investment in the U.S. market generally should be encouraged. Sprint Comments at 22.

[378] As WorldCom asserts, the benchmark conditions proposed by the Commission are "not a perfect economic solution because the proposed benchmarks are still well above economic cost," but the approach "deserves support because it attacks the crux of the problem: above-cost settlement rates." WorldCom Comments at 15.

rates are potentially able to engage in anticompetitive price squeeze behavior. We conclude that AT&T's proposal would be an overreaction to the potential for price squeeze. Moreover, to the extent carriers retain the ability to execute a predatory price squeeze, our authority to take enforcement action, including ordering that a carrier's settlement rates on an affiliated route be reduced to the level of our best practice rate, $0.08, or revoking a carrier's authorization will be a strong deterrent. We also note that in our *Foreign Participation Notice* we questioned whether we should impose certain competitive safeguards, including structural separation, to guard against anticompetitive behavior in the U.S. market for IMTS. Any such safeguards would be applied in addition to the Section 214 authorization conditions we adopt here.

223. AT&T asserts that, if we do not adopt its proposal to strengthen the condition for the provision of facilities-based switched service to affiliated markets, then we should retain the ECO test.[379] MCI also argues in favor of retaining the ECO test.[380] We will consider these arguments in our *Foreign Participation* proceeding, where we have sought comment on whether to apply the ECO test in light of the WTO Basic Telecom Agreement. In that *Notice*, we tentatively concluded that we should eliminate the ECO test as part of our public interest analysis of pending and future Section 214 applications filed by foreign carriers from WTO Member countries.[381]

224. We adopt a trigger to determine when market distortion has occurred, at which time we will take enforcement action. Such enforcement action may include requiring a carrier to lower its settlement rates on an affiliated route to the level of our best practice rate or revoking its authorization to provide service on the affiliated route. We establish a rebuttable presumption that a carrier has engaged in price squeeze behavior that creates distortions in the U.S. market for IMTS if the conditions of our bright line test are met. The bright line test we adopt is whether any of a carrier's tariffed collection rates on an affiliated route are less than the carrier's average variable costs on that route. For purposes of this bright line test, we define a carrier's average variable costs on the affiliated route as the carrier's net settlement rate plus any originating access charges.[382] These are the two primary expenses that a carrier would not incur in the short term if it stopped providing IMTS from

[379] AT&T Comments at 40-41; 46.

[380] MCI Comments at 9-10.

[381] *Foreign Participation Notice* at ¶32.

[382] *See* note 128, *supra*, for an explanation of "net settlement rate."

the United States to its affiliated market.[383] Most other expenses are fixed in the short term, and would be incurred regardless of whether the carrier provided service. If any tariffed collection rate is less than average variable costs, we will presume that the carrier is engaging in anticompetitive price squeeze behavior and we will take enforcement action. Such enforcement action may include a requirement that the carrier reduce its settlement rates on the affiliated route. Alternatively, we could revoke the carrier's authorization to serve the affiliated market.[384]

225. We believe that recovery of average variable costs is an appropriate threshold standard for determining the existence of price squeeze behavior because in the short run carriers can increase their profits (or minimize their losses) by offering service at a price at or above average variable costs. Thus, any price below that floor would indicate that the carrier is losing money by providing service. Alternatively, in the case of a U.S. affiliate of a foreign carrier, any price below the floor could indicate that the U.S. affiliate is attempting a price squeeze. Because the U.S. affiliate's net settlement payments are an intracorporate transfer and not a true cost, the U.S. affiliate could price its service in the U.S. market below average variable costs. We therefore believe that any price below average variable costs is suspect and that we should establish a rebuttable presumption of market distorting behavior. The presumption of market distortion can be rebutted by a showing that there is an economically justifiable reason for pricing below average variable costs. For example, a carrier could show that its pricing strategy is a time limited promotion in order to gain market share.

226. Data from which a U.S. carrier's net settlement rate can be calculated will be filed as part of the quarterly traffic reports we adopt in this *Order*. As discussed in Section II.C.2., the quarterly reports will contain the same data that are required in the existing Section 43.61 reports, including actual traffic and revenue data, but for facilities-based switched services and facilities-based switched resale services only.[385] Information on U.S.

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[383] We acknowledge that there are other long run variable costs that a carrier must recover to remain profitable. However, competitive markets often force firms to price at short run variable costs. We thus focus on short run variable costs for purposes of establishing a presumption of the existence of market distorting behavior.

[384] We note that the Commission eliminated the lower pricing bands for LEC price cap services. We believe, however, that because foreign-affiliated carriers have the ability to engage in a predatory price squeeze on affiliated routes, it is appropriate to establish a trigger for presuming that a foreign-affiliated carrier is engaging in price squeeze.

[385] *See* 47 C.F.R. §43.61. The data currently filed by carriers pursuant to the annual reporting requirement in Section 43.61 is compiled in an annual report prepared by the Industry Analysis Division of the Common Carrier Bureau.

carriers' access charges is available in tariffs filed with the Commission and in the Commission's annual Monitoring Report in CC Docket No. 87-339. We believe these reporting requirements will be sufficient to enable us to detect market-distorting price squeeze behavior. However, we will develop additional monitoring mechanisms in the future if necessary.

227. We may make a finding that the trigger for determining the existence of market distortion has been met on our own initiative or pursuant to a written request by any carrier providing IMTS on the route in question. Such written requests must provide evidence that any of a carrier's tariffed collection rates on an affiliated route is less than the carrier's average variable costs (average net settlement rate payments plus access charge payments) on the route. Such evidence may be based on the data filed pursuant to the Section 43.61 quarterly traffic report filing requirement that we adopt here, the annual Monitoring Report in CC Docket No. 87-339, a carrier's tariffs, or other sources. If we find, either on our own initiative or by request, that the presumption of market distortion has been met on an affiliated route, we will issue a public notice and notify the carrier providing service to the affiliated route. Once we make a finding, the carrier providing service to the affiliated route will be prohibited from using its authorization to provide switched services until it complies with our enforcement action or successfully presents evidence sufficient to rebut the presumption of market distortion.

228. In the *Notice*, we sought comment on whether we should impose the conditions for facilities-based service to affiliated markets on existing Section 214 certificate holders that serve affiliated markets.[386] We conclude that we should apply the conditions to existing Section 214 certificate holders. We see no reason to exempt carriers with existing authorizations from complying with conditions that will apply to all other carriers providing facilities-based service to affiliated markets. The same concerns about anticompetitive behavior we seek to address through our conditions apply equally to carriers with existing authorizations. We will therefore require existing Section 214 certificate holders that serve affiliated markets to negotiate with all U.S. international carriers a settlement rate for the affiliated route that is at or below the appropriate benchmark. The settlement rate must be negotiated and in effect within ninety days of the effective date of this *Order*.

229. We also sought comment in the *Notice* on a proposal to establish a presumption that carriers from countries that have opened their markets to meaningful competition have fulfilled our Section 214 conditions. We reasoned that our conditions would not be necessary under these circumstances because effective competition will best ensure that settlement rates are set at cost-based levels and thereby eliminate the potential for anticompetitive behavior

[386] *Notice* at ¶ 85.

from above-cost rates.[387] We conclude, however, that we should apply the Section 214 conditions to all carriers, including those from countries that have opened their markets to competition. The conditions are necessary to address the potential for market distorting behavior created by the existence of above-cost settlement rates. Even in countries which have meaningful competition, the potential exists for a carrier with a significant market share to create distortions in the U.S. market for IMTS if it is collecting above-cost settlement rates. We thus conclude that the Section 214 conditions should be applied to all carriers, including those from countries that have introduced competition. We note, however, that in markets where there is fully developed competition, settlement rates will likely be at or below the benchmarks we adopt in this *Order*. Thus, foreign-affiliated carriers providing service to those markets will not have to take any further action to comply with our conditions unless they engage in anticompetitive behavior.[388]

230. AT&T argues in an *ex parte* communication that we should apply the same condition we proposed in the *Notice* for authorizations to provide facilities-based switched service from the United States to an affiliated market to authorizations to provide switched resale service from the United States to an affiliated market.[389] AT&T first raised this argument in an *Ex Parte* dated July 10, 1997, to which it attached its comments in the *Foreign Participation* proceeding. We believe that AT&T's argument is better addressed in the *Foreign Participation* proceeding, where we will have a more complete record on the issue of applying the benchmark condition to facilities-based switched service. AT&T raised the issue in its initial comments in that proceeding, and parties will have an opportunity to comment in their reply comments, which are not due until after the adoption date of this *Order*.

231. In summary, we will condition authorizations to provide international facilities-based switched or private line service from the United States to an affiliated market in order to restrain the ability of foreign-affiliated carriers to engage in anticompetitive price squeeze behavior in the U.S. market. Specifically, we will condition any such authorization to serve an affiliated market on the affiliated carrier offering U.S. international carriers a settlement rate for the affiliated market at or below the relevant benchmark adopted in this *Order*. If,

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[387] *Id.*

[388] The United Kingdom has noted that cost-based alternatives for terminating traffic should be available in markets that permit foreign carriers to self-correspond. United Kingdom Comments at 4. There is no need, however, as the United Kingdom suggests, to distinguish between liberalized and monopoly markets in applying our benchmark conditions. While the condition may apply to liberalized markets, if rates are at or below the benchmarks, carriers will not have to take any further action unless they engage in market distorting behavior.

[389] Letter from James Talbot, AT&T, to William Caton, Acting Secretary, July 10, 1997.

after the carrier has commenced service to the affiliated market, we learn that the carrier's service offering has distorted market performance on the route in question, as determined by the rebuttable presumption we adopt here, we will take enforcement action. That action may include a requirement that the settlement rate of the affiliated carrier for the route be at a level equal to or below the best practices rate we adopt in this *Order*, $0.08, or a revocation of the authorization of the carrier to serve the affiliated market. We adopt a rebuttable presumption that a carrier's service offering has distorted market performance if any of the carrier's tariffed collection rates on the affiliated route are less than the carrier's average variable costs on that route.

2. Condition for Provision of Switched Services over Private Lines

a. Notice

232. We also proposed in the *Notice* a competitive safeguard to address the potential market distortions resulting from one-way bypass of the accounting rate system. Specifically, we proposed to grant carriers' applications for authority to resell international private lines to provide switched services on the condition that settlement rates on the route or routes in question are at or below the appropriate settlement rate benchmark. Under the proposed condition, if any settlement rate on the route in question is higher than the appropriate benchmark, a resale carrier would not be permitted to use its private line resale authorization to provide switched, basic services until such time as all settlement rates on the route are at or below the benchmark. We noted that this condition would apply to any U.S. carrier seeking to provide switched, basic services via resold private lines regardless of whether the carrier is operating on a particular route in correspondence with an affiliated foreign carrier. We reasoned that even an unaffiliated U.S. carrier would have the ability to distort competition on the route to the extent it accepted one-way bypass traffic from a foreign carrier. We also proposed to order all U.S. international carriers to pay a cost-based settlement rate if, after a carrier has commenced switched service via a resold private line, we learn that competition on the route has been distorted -- *i.e.*, that one-way bypass is occurring. We asked for comment on what mechanism or approach we should use to determine when competition has been distorted. We also sought comment on whether these proposed conditions should replace our

current private line resale policy[390] or whether that policy should be modified to ensure that it is compatible with the proposed conditions.

233. In our recent *Foreign Participation Notice*, we concluded that it might be necessary to supplement the condition that we proposed in the *Notice* to cover facilities-based carriers' use of their authorized private lines to route U.S. inbound and outbound switched traffic. We noted that facilities-based private line carriers also have the ability to distort competition on a particular route to the extent they terminate one-way bypass traffic from a foreign carrier. We therefore proposed to prohibit a U.S.-licensed facilities-based private line carrier from originating or terminating U.S switched traffic over its facilities-based private lines until all U.S. carriers' settlement rates for the country or location at the foreign end of the private line are at or below the appropriate benchmark.[391] In a Public Notice accompanying our *Foreign Participation Notice*, we invited interested parties to file supplemental comments on this proposal in this proceeding.[392]

b. Positions of the Parties

234. Many commenters agree that the settlement rate benchmarks should be used to condition authorizations to provide switched services over facilities-based or resold international private lines. They agree that such conditions are necessary to address possible distortions in the U.S. market from one-way bypass. Some commenters, however, urge us to strengthen the proposed conditions, while others urge us to loosen restrictions on the provision of international simple resale ("ISR").

235. ACC and Primus, for example, state that they would prefer us to permit ISR on all routes immediately because encouraging carriers to engage in ISR will enhance competition in the global IMTS market. However, they support the proposed conditions as a

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[390] Our private line resale policy permits U.S. carriers to resell international private lines to provide switched services to countries that afford resale opportunities equivalent to those available under U.S. law as an alternative to terminating traffic via the traditional settlement rate system. This policy is referred to as the "equivalency test." *See* Regulation of International Accounting Rates, CC Docket No. 90-337, Phase II, *First Report and Order*, 7 FCC Rcd 559 (1991) (*International Resale Order*). In our *Foreign Participation Notice*, we tentatively concluded that it is no longer necessary, or desirable from an administrative standpoint, to continue to apply the equivalency test to pending or future Section 214 applications to provide switched, basic services over private lines between the United States and WTO Member countries. *Foreign Participation Notice* at ¶ 50.

[391] *Foreign Participation Notice* at ¶ 121.

[392] Public Notice DA 97-1173 (rel. June 4, 1997).

way to address our concern about one-way bypass.[393] ACC agrees with us that the proposed conditions address the concern that one-way bypass could distort competition.[394]

236. TNZL opposes our proposed conditions on the basis of a similar concern to that raised by ACC and Primus, that the proposed conditions could undermine our objective of exerting downward pressure on the level of settlement rates. TNZL notes that the logical effect of the provision of switched services over resold international private lines is to put pressure on settlement rates. TNZL concludes that we "should not require that the effect exist before the cause."[395] The United Kingdom also cites the procompetitive benefits of ISR and urges us to consider extending the ability to provide ISR services to as many routes as possible. The United Kingdom suggests that we consider permitting ISR on routes where the benchmarks have not been reached, provided other safeguards against one-way bypass are in place.[396] Viatel also cites the procompetitive benefits of ISR services and further argues that the proposed condition is not necessary because there has been no evidence to date of one-way bypass in the U.S. market.[397]

237. Japan recognizes there is a possibility of "trade distortion caused by monopolist carriers bypassing the international settlement rate system in non-liberalized countries."[398] Nonetheless, Japan objects to the proposed condition on resale of private lines to provide switched service. Japan notes in particular that the proposal that all settlement rates must be within the benchmark range before a carrier can use its authorization to provide switched services over private lines is too restrictive and means that market entry for some carriers would be contingent upon the level of accounting rates over which they have no control. TNZL is concerned that this aspect of our proposed conditions could give U.S. carriers' foreign correspondents effective control over whether they will face competition in switched services from international private line resellers. TNZL notes that any foreign carrier could block the entry of a competitor providing ISR simply by refusing to reduce the settlement rate on the route.[399]

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[393] Primus Comments at 3-5; ACC Comments at 6-7.

[394] ACC Comments at 6-7.

[395] TNZL Comments at 9; *see also Viatel July 11, 1997 Ex Parte* at 4-5.

[396] United Kingdom Comments at 5.

[397] Viatel July 11, 1997 *Ex Parte* at 5-6.

[398] Japan Comments at 2.

[399] TNZL Comments at 9-10.

238. GTE objects to our proposal to apply the resale condition to the provision of switched services over facilities-based private lines. GTE states that the proposal is unnecessary in light of the fact that market forces created by the WTO Basic Telecom Agreement will drive down settlement rates.[400] GTE further argues that there is no demonstrated link between above-cost settlement rates and competitive distortion. GTE notes that we claim only that one-way bypass could occur, not that it has or will.[401]

239. AT&T and MCI, on the other hand, urge us to strengthen the proposed condition by requiring that settlement rates on the route or routes in question be at the low end of the benchmark range as a condition of carriers' authorizations to resell international private lines to provide switched service to the United States.[402] AT&T also argues that this more stringent condition should apply to the provision of switched services over facilities-based private lines.[403] AT&T argues that this more stringent condition is necessary because the settlement rate benchmarks exceed the incremental costs of providing international service. As a result, foreign carriers would still have an incentive to send their traffic to the United States over private lines while continuing to collect above-cost benchmark rates. According to AT&T, this is problematic because the difference between ISR rates a carrier would pay to terminate traffic in the United States and the benchmark settlement rates a carrier would receive to terminate traffic from the United States "would provide significant margins for foreign carriers on every minute delivered to the U.S."[404] AT&T concludes that if we adopt the conditions as proposed, it would be necessary to retain the present equivalency test to protect against one-way bypass.[405]

240. WorldCom agrees generally with our proposed conditions. However, it suggests some modifications to the proposals. Specifically, WorldCom proposes a three-prong test where ISR would be allowed on a route if any one prong is satisfied. Under WorldCom's proposed test, ISR would be allowed under any one of the following circumstances: (1)

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[400] GTE Comments at 1-3.

[401] GTE Supplemental Comments at 5-6.

[402] AT&T Comments at 35-36; MCI Reply at 8-9.

[403] AT&T Supplemental Comments at 2-3. In its Supplemental Comments, MCI states that it supports the Commission's proposal to prohibit U.S. facilities-based private line carriers from originating or terminating U.S. switched traffic over their private lines until all U.S. carriers' settlement rates on the route in question are within the relevant benchmark range. MCI Supplemental Comments at 1-2.

[404] AT&T Comments at 36.

[405] *Id.* at 35-36.

where ISR is already authorized on the route as of the effective date of the *Order*; (2) where the settlement rate for more than 50% of outbound traffic on a particular route is within the benchmark; or (3) where the Commission determines that the foreign market offers equivalent opportunities for ISR.[406] WorldCom states that the second prong of its proposed test is a clarification of our proposed conditions to address situations where there are multiple foreign correspondents on a route. With respect to the third prong, WorldCom states that there could be situations where the prevailing settlement rate is not within the benchmark, but the country offers equivalent opportunities for U.S. carriers to engage in ISR. In those situations, WorldCom submits, permitting ISR would put additional pressure on high settlement rates and should be allowed.[407]

241. WorldCom also suggests a mechanism for detecting competitive distortion, *i.e.*, one-way bypass, that is based on the aggregate inbound/outbound ratio of settled traffic on a route. WorldCom suggests that if the percentage of outbound traffic relative to inbound increases by a 10 or more percent across two measurement periods, there should be a presumption that inbound traffic is being disproportionately diverted from the settlement process to ISR routing. WorldCom states that the 10 percent threshold should provide sufficient leeway for routine traffic shifts.[408] AT&T, however, is skeptical that such monitoring procedures would provide an effective remedy for market distortions. AT&T is concerned that reliance upon the Commission's only existing monitoring activities, the annual Section 43.61 reporting process, would delay action for at least nine months after the end of the calendar year in which bypass occurred. The introduction of more frequent reports would, according to AT&T, impose costly compliance burdens and could disclose competitively sensitive information. AT&T also notes that existing Commission reporting requirements for carriers authorized to provide switched services over international private lines have been widely ignored. Finally, AT&T questions how the Commission could distinguish traffic shifts resulting from one-way bypass from those resulting from callback, refile, or other procompetitive market changes.[409]

c. Discussion

242. The comments reflect the dilemma faced by the Commission. The provision of switched services over private lines has strong procompetitive effects in the marketplace. As

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[406] WorldCom Comments at 18.

[407] *Id.* at 19.

[408] *Id.* at 20.

[409] AT&T Reply at 49-50; *see also* KDD Reply at 8.

we stated in the *International Resale Order*, a more liberal policy with respect to resale of international private lines will allow new entities to enter the market and offer services such as IMTS. This new entry will compel carriers at both ends of the circuit to bring their prices closer to cost to avoid losing their current customers to resale providers.[410] But at the same time, the procompetitive effects of private line resale must be weighed against the market distorting effects of one-way bypass.[411] The threat of one-way bypass of the accounting rate system cannot be ignored. It has significant implications for competition in the U.S. market for IMTS, and consequently, for U.S. consumers. One-way bypass exacerbates the U.S. net settlements deficit and ultimately increases the burden on U.S. ratepayers through higher rates for IMTS. Contrary to Viatel's claim, the fact that we have not had to take action against carriers for one-way bypass in the past does not mean the concern about one-way bypass is speculative. The reason we have been able to avoid one-way bypass in the past is our equivalency policy. That policy permits private line resale only to countries that afford resale opportunities equivalent to those available under U.S. law. However, in our recent *Foreign Participation Notice*, we tentatively concluded that it is no longer necessary to continue to apply the equivalency test to applications to provide such service to WTO Member countries.[412]

243. We believe the condition we proposed in the *Notice*, with some modifications, balances our desires to encourage ISR and at the same time limit the potential for one-way bypass. Accordingly, we adopt the condition as proposed in the *Notice* with two modifications. The first modification is that we will authorize carriers to provide switched services over resold international private lines between the United States and foreign destination countries on the condition that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route or routes are at or below the appropriate benchmark, as proposed by WorldCom. If we learn that competition on the route in question has been distorted, *i.e.*, carriers are engaging in one-way bypass, we will take enforcement action. Such enforcement action may include a requirement prohibiting carriers from using their authorizations to provide switched services over private lines on that route until settlement rates for at least 50 percent of the settled U.S. billed traffic on the route are at or below the level of our best practice rate of $0.08, or revocation of a carrier's authorization.

244. In the *Notice*, we proposed to require that all settlement rates on the route in question be within the benchmarks. Our proposal to require that all settlement rates on the

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[410] *International Resale Order*, 7 FCC Rcd at 560.

[411] Telia states that it has the same concern about one-way bypass in the Swedish market. Telia Comments at 3-4.

[412] *Foreign Participation Notice* at ¶ 50.

route be at the appropriate benchmark levels, rather than only the resale applicant's settlement rates, was intended to address the situation where the Section 214 applicant was a pure reseller. In that case, it would be meaningless to require a pure reseller to comply with settlement rate benchmark conditions because a pure reseller would not have established a settlement rate with any U.S. correspondent. Upon further consideration, however, we do not believe it is necessary to require *all* settlement rates on the route in question to be within the benchmarks. Our concern, as discussed above, is with the potential for one-way bypass and its effects on the U.S. net settlements payment and U.S. consumers. To the extent carriers providing service outbound from the United States have low cost alternatives to terminate their traffic on the route in question, one-way bypass would not have a significant effect on the U.S. net settlements payment and prices paid by U.S. consumers. We believe that any carrier or combination of carriers with 50 percent of the market for termination of outbound traffic from the United States would have sufficient capacity to handle all traffic from U.S. carriers. Thus, even if no other carrier on the route had settlement rates at or below the relevant benchmark, U.S. carriers would be able to terminate all of their outbound traffic on the route with a carrier whose rates are at or below the benchmark. Moreover, it is likely that if the settlement rates for 50 percent of the settled U.S. billed traffic were at or below the relevant benchmark, the rates for the rest of the traffic would be at that level also. We note that requiring settlement rates for only 50 percent of the settled U.S. billed traffic on the route in question to be at or below the benchmarks will alleviate the concerns stated by TNZL and Japan that facilities-based carriers could control resellers' ability to provide services.

245. The second modification we make to the proposed condition is to apply it to U.S. *facilities-based* carriers' use of their authorized private lines for the provision of switched, basic services. As we stated in the *Foreign Participation Notice*, facilities-based private line carriers also have the ability to distort competition on a particular route to the extent they terminate one-way bypass traffic from a foreign carrier. Because the same concerns exist for both facilities-based private line carriers and carriers that provide service over resold private lines, the same condition should apply to both services. We therefore will permit carriers to use their authorized facilities-based private lines to originate or terminate U.S. switched traffic on the condition that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route or routes in question are at or below the appropriate benchmark. If we learn that competition on the route in question has been distorted, *i.e.*, carriers are using their authorized private lines to engage in one-way bypass of the accounting rate system, we will take enforcement action as described in this *Order*.

246. We disagree with GTE that there is no link between above-cost settlement rates and competitive distortion from one-way bypass over facilities-based private lines. Above-cost settlement rates create the financial incentive for carriers to avoid the settlements system by sending traffic over private lines. We also disagree that the condition for the provision of switched services over facilities-based or resold private lines is not necessary because market

forces are creating downward pressure on settlement rates. GTE is correct in asserting that competitive market forces, driven in large part by the WTO Basic Telecom Agreement, are creating downward pressure on settlement rates. However, even where there are competitive pressures, rates are not always at cost-based levels. Moreover, many markets are still dominated by monopoly providers.

247. We disagree with AT&T and MCI that we should require accounting rates to be at the low end of the benchmark before carriers may use their authorizations to provide switched services over facilities-based or resold private lines. Such a condition is not necessary to prevent distortions in the U.S. market for IMTS services, and in fact, it could harm the development of further competition in that market. We believe that AT&T and MCI's proposed conditions could effectively deter many carriers from providing switched services over facilities-based or resold private lines. As discussed above, and as many commenters note, these services exert downward price pressure on both ends of a route. We should therefore encourage the development of these services to the greatest extent possible consistent with our goal of preventing the market distortions that result from one-way bypass.

248. AT&T and MCI are correct in asserting that because the settlement rate benchmarks are above-cost, the condition as proposed in the *Notice* does not completely eliminate the incentive for carriers to engage in one-way bypass. However, the requirement that settlement rates be at or below the relevant benchmark before carriers may use their authorizations substantially reduces the financial incentive to engage in one-way bypass. In addition, we believe that our authority to take enforcement action if we detect market distortion will be an effective deterrent to one-way bypass. Finally, to the extent incentives to engage in one-way bypass remain, the mechanism we adopt in this *Order* for detecting market distortion will provide a timely remedy. We discuss this mechanism below.

249. We adopt WorldCom's proposal that the mechanism for detecting whether there has been competitive distortion on a particular route be based on the aggregate outbound/inbound ratio of settled traffic on the route. Similar to WorldCom's suggestion, we will adopt a presumption that market distortion exists, *i.e.*, inbound switched traffic is being diverted from the accounting rate system to facilities-based or resold private lines, if the ratio of outbound (U.S.-billed) to inbound (foreign-billed) settled traffic increases 10 or more percent in two successive quarterly measurement periods. For example, the presumption of market distortion would be met if the traffic ratio at the beginning of a quarterly measurement period was 60 percent outbound traffic and 40 percent inbound traffic and the traffic ratio at the end of the subsequent quarterly measurement period (*i.e.*, six months later) had changed to 65 percent outbound traffic and 35 percent inbound traffic.

250. We agree with WorldCom that a 10 percent threshold should provide sufficient leeway in most cases for routine traffic shifts. We also believe, contrary to the concerns

raised by AT&T and KDD, that increases in the traffic imbalance due to callback, refile, or other procompetitive market changes generally will not trigger the 10 percent threshold. In most cases, these services would not contribute to a 10 or more percent increase in the traffic imbalance over the course of two reporting periods. Moreover, the presumption of market distortion can be rebutted by a showing that 10 or more percent increase in the traffic imbalance is due to factors other than one-way bypass, such as callback.

251. We amend our reporting requirements in Section 43.61 of our rules to enable us to detect market distortion.[413] Section 43.61 requires each common carrier that provides international service between the United States and any foreign country to file an annual report. The annual report includes actual traffic and revenue data for each service provided by a common carrier, divided among service billed in the United States, service billed outside the United States, and service transiting the United States. We will amend this reporting requirement to require that quarterly traffic reports be filed by certain common carriers in addition to the annual report. Specifically, we will require common carriers subject to the existing Section 43.61 requirements to file traffic reports for each quarter in which their traffic meets any of the following thresholds: (i) their aggregate U.S.-billed minutes of switched telephone traffic exceeds 1 percent of the total of such minutes of international traffic for all U.S. carriers (as published in the most recent Section 43.61 traffic data report);[414] (ii) their aggregate foreign-billed minutes of switched telephone traffic exceeds 1 percent of the total of such minutes of international traffic for all U.S. carriers; (iii) their aggregate U.S.-billed minutes of switched telephone traffic for any country exceeds 2.5 percent of the total of such minutes for that country for all U.S. carriers; or (iv) their aggregate foreign-billed minutes of switched telephone traffic for any foreign country exceeds 2.5 percent of the total of such minutes for that country for all U.S. carriers. Limiting the quarterly filing requirement to carriers that meet these criteria will reduce the burden on small carriers, while enabling us to identify distortions in the balance of payments. The filing of these reports also makes unnecessary the filing of the semi-annual reports we have required to be filed by carriers providing switched services over resold private lines for the first three years following an equivalency determination.[415]

252. We will require carriers that are subject to this quarterly reporting requirement to provide the same data called for in the existing Section 43.61 reports. However, we will

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[413] *See* 47 C.F.R. § 43.61.

[414] Section 43.61 International Telecommunications Data, Industry Analysis Division, Common Carrier Bureau.

[415] *See generally* Streamlining the International Section 214 Authorization Process and Tariff Requirements, *Report and Order*, 11 FCC Rcd 12,884 (1996); *Foreign Carrier Entry Order* at ¶ 170.

require that carriers file this data only for switched facilities-based telephone services and switched facilities resale telephone services.[416] This data will enable us to detect whether one-way bypass is occurring. We note that some carriers may be carrying non-settled switched traffic over their private line facilities and reporting this traffic as facilities-based switched traffic in their Section 43.61 reports. We take this opportunity to clarify that only settled traffic should be included in the Section 43.61 reports as facilities-based switched service. We define settled traffic for purposes of these reports as all traffic settled under an arrangement that meets the requirements of our ISP[417] or has been approved as an alternative settlement arrangement under our *Accounting Rate Flexibility Order*. Carriers that are carrying non-settled traffic over their private line facilities should report that traffic as switched facilities resale service.

253. Each carrier covered by this new quarterly filing requirement shall file a quarterly traffic report with the Commission no later than April 30 for the prior January through March quarter; no later than July 31 for the prior April through June quarter; no later than October 31 for the prior July through September quarter; and no later than January 31 for the prior October through December quarter.[418]

254. Contrary to the concerns raised by AT&T, we do not believe these quarterly reports will be unduly burdensome. We are not changing the substance of our current Section 43.61 reporting requirement. We are simply increasing the frequency with which a subset of the data must be consolidated and reported. Carriers subject to our Section 43.61 annual reporting requirement should already be collecting the data on an ongoing basis. Moreover, we believe these traffic reporting requirements enable us to strike a reasonable balance between encouraging entry and competition and preventing one-way bypass. With these reporting requirements, we believe it is not necessary to adopt AT&T's proposed alternative

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[416] Data for service classified as Service Code 1 including data categorized as billing codes 1-14, as set forth in the Section 43.61 reporting manual. Carriers need not file data for Telegraph, Telex or miscellaneous services, Service Codes 2, 3, and 99, respectively.

[417] For background on the Commission's ISP, *see* Implementation and Scope of the International Settlements Policy for Parallel Routes, CC Docket No. 85-204, *Report and Order*, 51 Fed. Reg. 4736 (Feb. 7, 1986) (*ISP Order*), *modified in part on recon.*, 2 FCC Rcd 1118 (1987), *further recon.*, 3 FCC Rcd 1614 (1988). *See also* Regulation of International Accounting Rates, CC Docket 90-337, *Report and Order*, 6 FCC Rcd 3552 (1991), *on recon.*, 7 FCC Rcd 8049 (1992).

[418] AT&T contends that our existing Section 43.61 traffic reports would not provide timely data to detect market distortion because there is a considerable lag between the end of the reporting period and the date data are filed. AT&T Comments at 37-38. This concern does not apply to the new quarterly reporting requirement we adopt here, as data will be filed one month after the end of the reporting period.

that we grant authorizations to provide switched services over facilities-based or resold private lines on the condition that all accounting rates on the route in question are at or below the low end of the benchmarks. We note AT&T's concern that more frequent traffic reporting could disclose commercially sensitive information. We find such concerns outweighed, however, by the compelling public interest benefits of permitting ISR once settlement rates for at least 50 percent of the settled U.S.-billed traffic on a particular route are at or below the level of the appropriate benchmark. We also note AT&T's concern that many carriers do not comply with the Commission's current reporting requirements. We emphasize that we have authority to issue fines to those carriers that do not comply with our reporting requirements.[419] We intend to enforce these requirements and will take all action necessary to ensure that the quarterly traffic reports are filed in a timely manner.

255. The presumption of market distortion can be rebutted by any carrier whose authorization to provide switched services over facilities-based or resold private lines is affected by the determination that there is market distortion. The presumption can be rebutted by a showing that the change in the inbound/outbound ratio is caused by factors other than one-way bypass, such as an increase in callback traffic.

256. We may make a finding that the rebuttable presumption of market distortion we adopt in this *Order* has been met on our own initiative, or pursuant to a written request by any carrier providing IMTS on the route in question. Such written requests must provide evidence that the percentage of outbound traffic relative to inbound traffic increased 10 or more percent in two successive measurement periods. If we find, either on our own initiative or by request, that the presumption of market distortion has been met on a particular route, we will issue a public notice and notify all carriers authorized to provide switched services over facilities-based or resold private lines on that route of our finding. Commencing on the date we issue a public notice that the presumption of market distortion has been met, carriers will be prohibited from using their authorizations to provide switched services over facilities-based or resold lines until they comply with our enforcement action or provide evidence sufficient to rebut the presumption of market distortion.

257. We believe that our rebuttable presumption based on a 10 or more percent change in the inbound/outbound ratio in two successive reporting periods will detect most instances of one-way bypass. However, it is possible that there may be instances where this mechanism for detecting one-way bypass is not effective. For instances in which market distortion is not evidenced by the 10 or more percent test, we may need to look at other market or individual carrier trends, similar to our process in determining that the rebuttable presumption has been met. We thus reserve the right to investigate other market or individual

[419] *See* 47 C.F.R. § 220.

carrier trends that could indicate one-way bypass. We may undertake such an investigation either on our own initiative or pursuant to a written request by any carrier providing IMTS on the route in question. If, based on our investigation, we conclude that one-way bypass is occurring, we will issue a public notice and notify all carriers authorized to provide switched services over facilities-based or resold private lines on the route in question of our finding. Once we make a finding of market distortion based on an investigation, carriers must comply with our enforcement action until they submit evidence sufficient to rebut our finding of market distortion.

258. WorldCom and the United Kingdom suggest that we permit carriers to provide ISR where we determine that the foreign market offers equivalent opportunities for ISR, even if settlement rates on the route in question are not within the relevant benchmark.[420] TNZL also urges that the Section 214 authorization conditions not apply on routes we have found to be equivalent.[421] ACC and Primus argue that we should permit ISR on any route where it would result in market-based pricing and enhanced competition, and where it would not result in a carrier abusing its dominant market position. ACC and Primus state that such a policy should replace, not supplement, our equivalency policy.[422] GTE, on the other hand, argues that we should retain the equivalency test instead of adopting the Section 214 conditions we proposed in the *Notice*.[423] We will consider these suggestions about retaining or replacing our equivalency test in our *Foreign Participation* proceeding,[424] where we have sought comment on whether we should continue to apply our existing equivalency test in light of the WTO Basic Telecom Agreement.[425] We note, however, that the Section 214 conditions we adopt in this *Order* may become effective before we determine in the *Foreign Participation* proceeding whether to eliminate the equivalency test. Therefore, until we issue a decision in the *Foreign Participation* proceeding, carriers seeking authorization to provide switched services over

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[420] WorldCom Comments at 19; United Kingdom Comments at 5; *see also* GTE Supplemental Comments at 6-7 ("At an absolute minimum," the benchmark condition "should be limited to those instances where one-way bypass could actually occur." Thus, the condition should not apply if a foreign market would meet the equivalency test.).

[421] TNZL Comments at 11.

[422] ACC Comments at 4-5, 7-8; Primus Comments at 4-6.

[423] GTE Comments at 26-28.

[424] For the reasons discussed in this section, however, we decline to adopt GTE's suggestion that we not adopt the benchmarks conditions.

[425] *Foreign Participation Notice* at ¶¶ 28-59. We proposed in the *Foreign Participation Notice* to eliminate the equivalency test for the provision of switched, basic services over private lines between the United States and WTO Member countries. *Id.* at ¶50.

facilities-based or resold private lines must comply with both the Section 214 conditions we adopt in this *Order* and our existing equivalency test. We will amend Section 63.18 of the rules to require that applications for authority to provide switched services over resold or facilities-based international private lines between the United States and a particular country include, in addition to the required equivalency showing, a showing that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route in question are at or below the appropriate benchmark.[426] We will also amend Section 63.21 of the rules to set forth the conditions that we adopt in this *Order* for the provision of switched services over resold or facilities-based international private lines.[427]

259. In summary, we will condition the Section 214 authorizations of carriers to provide switched basic services over international facilities-based or resold private lines in order to prevent one-way bypass of the accounting rate system. Specifically, we will authorize carriers to provide switched services over international facilities-based or resold private lines[428] on the condition that settlement rates for at least 50 percent of the settled U.S. billed traffic on the route or routes in question are at or below the relevant benchmark adopted in this *Order*. If we learn that the rebuttable presumption of market distortion, *i.e.*, one-way bypass, has been met, we will take enforcement action. That enforcement action may include a requirement that carriers be prohibited from using their authorizations to provide switched services over private lines until settlement rates for at least 50 percent of the settled U.S. billed traffic on the route are at a level equal to or below the best practice rate of $0.08 adopted in this *Order* or a revocation of carriers' authorizations to provide service. We adopt a rebuttable presumption that one-way bypass is occurring if the percentage of outbound traffic relative to inbound traffic increases by 10 or more percent in two successive quarterly measurement periods and reserve the right to investigate other shifts in the inbound/outbound ratio to determine whether one-way bypass is occurring.

3. GATS Obligations

a. Notice

[426] We note that WorldCom's additional suggestion that facilities-based or resold private lines for the provision of switched basic services also be permitted where it is already authorized as of the effective date of this *Order* is moot. Settlement rates on routes where ISR has already been authorized are, or will be, within the benchmarks we adopt here. (Settlement rates for New Zealand will be within the benchmark range before the end of the one year transition period for upper income countries.) We will not require any further showings from carriers on routes for which we have authorized ISR already.

[427] These rule changes are set forth in Appendix B to this *Order*.

[428] We note that these are services interconnected to the public switched network on one or both ends.

260. In the *Notice*, we invited parties to comment on whether our proposed Section 214 authorization conditions would be consistent with any commitments made by the United States, including most favored nation obligations, in the event the WTO's Group on Basic Telecommunications reached an agreement on liberalizing trade in basic telecommunications service. As noted above, the WTO Basic Telecom Agreement was concluded on February 15, 1997.

b. Positions of the Parties

261. Some commenters contend that the Commission's proposed authorization conditions would constitute barriers to entry, in violation of the U.S. General Agreement on Trade in Services obligations.[429] Japan states generally that the proposed conditions will hamper the promotion of competition because they will make entry into the U.S. market for IMTS difficult. In Japan's opinion, the proposed conditions are a practical barrier to entry.[430] KDD states that while it is legitimate for a country to have laws against anticompetitive conduct, it must implement those laws on a post-entry, not a pre-entry basis.[431] HKTI similarly asserts that the proposed conditions are "market entry controls" in that they would have the same effect as conditioning entry.[432] The European Union states that the proposed conditions "may well result in a disguised market access barrier detrimental to competition by imposing constraints more burdensome than necessary on carriers seeking access to the U.S. market."[433] The European Union further states that we have not provided a clear and transparent definition of market distortion that would justify imposing the conditions.[434]

262. Japan also argues that "only foreign-related carriers are subject to the benchmark condition" for facilities-based service to affiliated markets. Japan thus concludes

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[429] *See* General Agreement on Trade in Services, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex IB, 33 I.L.M. 1167 (1994) (hereinafter "GATS").

[430] Japan Comments at 2; *see also* Telefónica de España Reply at 17-18. GTE makes the same claim with respect to the proposed condition for the provision of switched services over resold private lines. GTE Comments at 32.

[431] KDD Reply at 17; *Viatel July 11, 1997 Ex Parte* at 7.

[432] HKTI Reply at 6.

[433] European Union Comments at 4.

[434] *Id.* at 5.

that the condition could be inconsistent with the national treatment principle of the GATS.[435] GTE similarly argues that the condition would treat foreign-affiliated carriers differently and concludes that this would be a violation of the MFN principle of the GATS.[436] Telefónica de España contends that both conditions would discriminate among services and service suppliers of different countries in violation of the U.S. MFN obligation because they would restrict IMTS on routes with settlement rates not in compliance with the benchmarks.[437]

263. Some commenters assert that the Commission's concerns about anticompetitive behavior can be met by less restrictive means. With respect to the proposed conditions for authorizations to provide facilities-based service to affiliated markets, Japan argues that cross-subsidization can be avoided by less restrictive measures such as "proper application of regulations on users' rates."[438] Japan further argues that the concern about one-way bypass should only be a temporary problem, if one at all, between liberalized countries. Thus, it argues, "excessive government intervention" should be avoided.[439] GTE argues that the concern about one-way bypass could be addressed in a less burdensome manner than the condition we proposed in the *Foreign Participation Notice* for the provision of switched services over facilities-based private lines. GTE proposes that we require U.S. facilities-based carriers to furnish the Commission with sufficient information about traffic volumes and revenues on private lines for switched services and any impact on settlements and prices to permit us to make a judgment about actual competitive harm resulting from one-way bypass.[440] AT&T disagrees, arguing that the traffic reporting requirements advocated by GTE would be unduly burdensome.[441] Viatel asserts that to the extent the Commission is concerned about one-way bypass, it should limit its proposed condition to U.S.-inbound services where the U.S. end is open to the PSTN.[442]

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[435] Japan Comments at 4; *see also* HKTI Reply at 6 (conditions would discriminate among providers of similar services from different countries).

[436] GTE Comments at 30; *see also* Telefónica de España Reply at 10-11, 15 (condition would violate both MFN and national treatment obligations because it would be far more likely to apply to foreign-owned carriers than U.S.-owned carriers).

[437] Telefónica de España Reply at 10-11.

[438] Japan Comments at 3.

[439] *Id.*

[440] GTE Supplemental Comments at 8.

[441] AT&T Supplemental Reply at 3.

[442] *Viatel July 11, 1997 Ex Parte* at 8.

c. Discussion

264. The GATS imposes a number of obligations on WTO Members. All WTO Members are required to accord MFN treatment to like services and service suppliers of all other WTO Members, no matter what specific commitments a Member has made. MFN is essentially a nondiscrimination rule that requires each WTO Member to treat like services and service suppliers from all other WTO Members similarly.[443] As a result of the WTO Basic Telecom Agreement, many Members, including the United States, also took on national treatment obligations. National treatment is a nondiscrimination rule that requires a WTO Member to treat like services and service suppliers from other WTO Members as it treats its own services and service suppliers.[444] The GATS also requires measures related to domestic regulation to be reasonable, objective, impartial, and transparent.[445] All WTO Members retain the right under the GATS to maintain laws or regulations to protect competition in their markets, as long as the laws or regulations are applied in a manner consistent with the provisions of the GATS.[446] Our Section 214 authorization conditions are consistent with these obligations. They are reasonable measures based on objective analysis designed to protect competition in the U.S. market for IMTS, and they apply to all carriers providing service in the United States.

265. The Section 214 authorization conditions apply to all U.S. carriers, whether U.S. or foreign-owned, and apply to all routes. Contrary to the arguments of GTE and Japan, all facilities-based carriers operating in the United States would face the same conditions on service to routes on which they have affiliation on the foreign end. Similarly, the resale condition applies to all carriers, U.S. or foreign-owned, seeking to provide switched services over resold international facilities-based or private lines. Moreover, contrary to Telefónica de España's argument, the conditions do not discriminate among services and service suppliers of different countries or discriminate in favor of U.S.-owned service suppliers. The conditions apply equally to all routes. The fact that the universally-applied conditions may be met on some routes and not on others does not mean that the conditions are inconsistent with our MFN and national treatment obligation.

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[443] Article II of the GATS requires WTO Member countries to accord "service and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country."

[444] *See* GATS art. XVII.

[445] *See* GATS arts. III, VI.

[446] In this regard, we agree with Telefónica de España that Article VI of the GATS does not provide an exception to other GATS obligations. Telefónica de España Reply at 20.

266. We disagree with commenters who assert that our benchmarks conditions are more burdensome than necessary and are an effective barrier to entry. We believe that the conditions we adopt in this *Order* are necessary to protect competition in the U.S. market for IMTS. As discussed above, above-cost settlement rates create a potential for distortion in the U.S. market. These are not merely hypothetical distortions. Moreover, contrary to the European Union's assertions, we have clearly defined market distortion in both the facilities-based and resale context.[447] We have shown that the collection of above-cost settlement rates gives foreign-affiliated carriers the ability to price below the level of its costs on affiliated routes. We have also shown that the above-cost accounting rate system creates the potential for one-way bypass if a carrier outside the United States is able to send its switched traffic over private lines into the United States, but carriers in the United States must continue to send their traffic over the accounting rate system. Consistent with our GATS obligations, we are taking measures to protect competition in the U.S. market by adopting authorization conditions to prevent these market distortions created by above-cost settlement rates.

267. Japan argues that anticompetitive behavior in the market for facilities-based services could be avoided by "less restrictive measures" such as rate regulation.[448] We disagree. We do not believe that regulation of end-user rates is a less restrictive measure than the conditions we adopt in this *Order*. In fact, rate regulation is extremely burdensome and would require extensive cost data from all carriers providing service in the U.S. market, including foreign-affiliated carriers. Viatel contends that if we believe we must address the concern about one-way bypass, we should limit our Section 214 condition to U.S.-inbound services where the U.S. end is open to the public switched network. We do not believe that such a condition would effectively address the concern about one-way bypass because it would be difficult to monitor carrier's traffic flows with such a limited condition. Once a carrier starts providing service, it is difficult to detect whether the carrier is providing inbound or outbound services only. We also disagree with GTE's claim that harm from one-way bypass can be avoided by requiring U.S. carriers to file information that would enable us to determine whether such harm has actually occurred. We do not believe this approach would be sufficient to address our concern. One-way bypass can substantially increase the U.S. net settlements deficit in a very short period of time. Thus, to the extent possible, we believe we must eliminate the incentive of carriers to engage in one-way bypass. The Section 214 authorization condition we proposed in the *Notice* substantially reduces foreign carriers' incentive to engage in one-way bypass by eliminating the financial advantages of doing so. We believe it is appropriate, and consistent with our right under the GATS to maintain reasonable measures to prevent market distortions in order to protect competition in the U.S. market. Our condition for the provision of switched services over facilities-based and resold

[447] *See* Sections II.C.1 and II.C.2., *supra.*

[448] Japan Comments at 3.

private lines represents a reasonable balance between encouraging private line services and preventing distortions in the U.S. market.

D. Effect of Settlement Rate Savings on U.S. Consumers

1. The Notice

268. We sought comment in the *Notice* on how to encourage U.S. carriers to reflect the reductions they receive in their settlement rates in their prices to consumers. We stated that our goal in reforming the settlement rate system was to provide U.S. consumers with just and reasonable rates for IMTS service. We noted that reductions in U.S. international carriers' rates to reflect settlement rate reductions would stimulate calling volume. We said that not only would this benefit U.S. international carriers by increasing their collection revenues, but also would benefit foreign carriers because they could offset lower settlement rate levels with an increase in the number of minutes terminated.[449]

2. Positions of the Parties

269. Many foreign commenters argue that we should focus on collection rates rather than settlement rates.[450] They argue that high U.S. collection rates deter outbound calling and reduce the ratio of outbound to inbound calls to the detriment of foreign carriers. Several commenters contend that U.S. international carriers have not passed on settlement rate reductions to consumers in the past and there is no assurance that any reduction in settlement payments that results from adoption and enforcement of benchmarks will be passed on to U.S. consumers.[451] Many of these commenters urge us to require that U.S. international carriers pass on any reductions in settlement rates to U.S. consumers.[452] Telstra recommends that we

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[449] Notice at ¶ 91.

[450] *See, e.g.*, Telefónica de España Comments at 29-32; Singapore Tel Comments at 10; Telstra Comments at 5; Telmex Comments at 14; HKTI Reply at 21; Telekom Malaysia Reply at 3.

[451] TSTT Comments at 5; HKTI Comments at 11; GTE Reply at 18-19; Panama Reply at 8-10; Singapore Telecom Reply at 10-11; IDC Comments at 6; *see also* Letter from Tom Bliley, Chairman, John Dingell, Ranking Democratic Member, W.J. "Billy" Tauzin, Chairman, Subcommittee on Telecommunications, Trade and Consumer Protection, Michael G. Oxley, Chairman, Subcommittee on Finance and Hazardous Materials, Committee of Commerce, U.S. House of Representatives, to Reed E. Hundt, Chairman, Federal Communications Commission, dated January 29, 1997 ("The Commission's work to reduce settlement rates to cost is vitally important to U.S. consumers . . . [t]herefore, we intend to monitor whether settlement rate reductions are resulting in consumer price reductions.").

[452] *See, e.g.*, HKTI Comments at 21.

require U.S. international carriers to report to us annually the average tariffed rates for IMTS on July 31 and December 31 for the top fifty routes on which U.S. international carriers have settlement deficits.[453] Some carriers argue that we should regulate the level of U.S. carriers' rates for international services. For example, KDD states that we should require U.S. carriers to offer rates for international direct dial service that are no higher than the applicable rates they would charge to their callback customers in a foreign country for calls to the United States.[454] AT&T states that it will ensure that net savings in settlement costs are passed on to U.S. consumers.[455] WorldCom argues that a mandatory flow-through requirement is unnecessary in the "highly competitive" U.S. telecommunications market -- especially in the markets for carrier-to-carrier and commercial services.[456]

3. Discussion

270. We agree with those commenters that contend U.S. consumers should benefit from the settlement rate reductions that result from our adoption and enforcement of settlement rate benchmarks. We expect that settlement savings as a result of the rules we adopt here will be substantial and will therefore significantly lower U.S. carriers' cost of providing IMTS. However, we disagree with those commenters that argue that competition in the U.S. market for international services may be insufficient to ensure that settlements savings are fully reflected in reduced collection rates. As we noted in the *AT&T International Nondominance Order,* competition in the U.S. market for IMTS is not as robust as we would like.[457] However, we anticipate that the U.S. market for IMTS will become increasingly competitive as a result of the WTO Basic Telecom Agreement. The Section 214 authorization conditions we adopt here will help promote further competition in the U.S. market for IMTS by addressing potential market distortions created by above-cost settlement rates. Moreover, the eventual entry of new entrants such as the Bell Operating Companies into the international services market will further increase competition. We believe that we should, to the extent possible, preserve the ability of U.S. carriers to make pricing decisions in response to these competitive market forces. We thus find that it is not in the public interest

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[453] Telstra Comments at 5 (recommending that the first report to us should include data for the previous five years).

[454] KDD Comments at 10.

[455] AT&T "commits to reduce its U.S. international rates to reflect fully AT&T's net settlement cost reductions resulting from the Commission's enforcement of new benchmarks." AT&T Reply at 25.

[456] WorldCom Reply at 7-8.

[457] In the Matter of Motion of AT&T Corp. to be Declared Non-Dominant for International Service, *Order*, FCC 96-209 at ¶ 85 (rel. May 14, 1996) ("*AT&T International Nondominance Order*").